TABLE 5. PERCENT DISTRIBUTION OF 1977 REPORTED EARNINGS REPLACEMENT RATES FOR SURVEY RESPONDENTS DISABLED BETWEEN 1972 AND 1976, BY RESPONDENT CATEGORY

	Replacement Rates[a]				
Respondent Category	0	Above 0 and Below .35	.35-.60	.61-1.0	Above 1.0
Disabled Respondents	69	12	11	5	3
Disabled Beneficiaries	--	38	35	15	12
Severely Disabled Respondents	50	15	20	8	7
Severely Disabled Beneficiaries					
All	--	31	39	16	14
SSDI Only	--	36	36	14	14
SSDI Plus Others[b]	--	16	38	27	19
SSDI Plus Nonwelfare[c]	--	17	36	26	21

Source: CBO tabulations of the Social Security Administration's 1978 Disability Survey data.

a. The replacement rate is defined as the ratio of disability cash benefits to predisability gross earnings (wage-indexed). Earnings in the year before the occurrence of the work-limiting disability were used in the computation.

b. All other sources of disability benefits are included. Major public and private sources of disability benefits were referenced on the 1978 Survey questionnaire, but a catch-all category was used for other nonreferenced disability benefits.

c. All other public sources of disability benefits are included except SSI, AFDC, and public assistance payments. Veterans' pensions could not be separated from compensation payments, however.

d. Sample sizes for these replacement intervals were too small for reliable estimates.

to decline in the future, however, since the Disability Amendments of 1980 (Public Law 96-265) placed a special cap on SSDI family benefit levels for new cases--the lesser of 85 percent of the average indexed monthly earnings or 150 percent of the worker's benefit. The family benefit cannot be less than the computed worker-only benefit, however, so that many low earners who receive SSDI and often means-tested benefits are protected from reductions in cash benefits resulting from this cap.

Although benefits to dependents are not the primary objective of disability programs, disability benefits that are intended as indemnity payments often include allowances for dependents that increase with the number of dependents. In veterans' programs, for example, there is no limit on the amount of additional dependents' benefits. This practice significantly raises the level of compensation for those with dependents, but causes different treatment of similarly impaired persons. Another example is that FECA recipients who have dependents receive benefits that equal 75 percent of their previous gross earnings, whereas single beneficiaries and recipients of state workers' compensation payments seldom receive benefits this high.

High Benefits Not Based on Previous Earnings. High disability benefits relative to previous earnings can be received when benefits are not based on previous earnings. Many receiving veterans' compensation, for example, receive benefits substantially in excess of what they earned before they were disabled. Previous earnings for many disabled veterans--for example, draftees disabled in war service--consisted of military pay that was substantially lower than the benefits received. Totally disabled veterans receive at least $1,130 per month in compensation

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17. (continued)
particularly those awarded benefits between 1972 and 1979. Benefit computations for future disabled workers will be less generous because of changes enacted in 1977, 1980, and 1981 laws (see earlier discussion in this chapter). Replacement rates for many of those who receive high replacements--that is, younger disabled workers and disabled workers with dependents--were significantly reduced. For example, the maximum replacement rate for a 30-year-old average earner in 1977 was about 104 percent compared to 66 percent for such an earner in 1981. (These data were obtained from unpublished Social Security Administration data.)

and those with families can receive additional amounts--for example, $116 per month for a spouse and child. On an annual basis, the family benefit of $14,952 is about 1.2 times the average military pay in 1981, twice the full-time minimum wage, and almost twice the average SSDI benefit for a similar family.

Since veterans' compensation is looked upon as an indemnity payment for losses incurred while in service, wage replacement may not be an appropriate or relevant benchmark for these payments. Also, high benefits relative to earnings can be received by recipients of welfare programs, such as SSI or veterans' pensions, although these welfare payments are low.

High Cumulative Benefits from More than One Program. Earnings replacement rates are generally higher for recipients of benefits from multiple sources than for single-program beneficiaries, and a significant number of those disabled persons who receive some disability compensation receive benefits from more than one program. According to survey data, more than 20 percent of recently disabled beneficiaries receive benefits from more than one program; most receive SSDI as one form of compensation (see also Appendix D, tables D-3 and D-4).[18] Among SSDI beneficiaries

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18. According to the Social Security Administration's surveys, in 1978, about 31 percent of SSDI beneficiaries received benefits from another public program. Higher proportions of veterans' and civil-service disability retirement beneficiaries--41 and 48 percent, respectively--also received benefits from at least one other program according to survey results; many of these beneficiaries, however, received SSDI as the other program benefit in 1978. See also L. Scott Muller, "Receipt of Multiple Benefits by Disabled-Worker Beneficiaries," Social Security Bulletin (November 1980), pp. 3-19. This article reports receipt of benefits from multiple sources based on the 1972 Disability Survey. In the 1972 survey, disability and retirement benefits were not separable in many instances; however, the study found 44 percent of SSDI beneficiaries to be recipients of multiple benefits. A study by the General Accounting Office found that only 16 percent of SSDI beneficiaries on the rolls in March 1980, who were disabled in 1977 or 1978, received benefits from multiple sources. See U.S. General Accounting Office, Limits on Benefits from Multiple Sources Could Save Millions, pp. 2-4.

first severely disabled between 1972 and 1976, almost half of those with benefits from another program had more than 60 percent of their last year's earnings replaced and 19 percent had more than 100 percent of earnings replaced (see Table 5). In addition, 20 percent of those receiving benefits from veterans' programs and other public sources, including SSDI, replaced more than 100 percent of previous earnings.

Receipt of benefits from more than one disability program does not always mean receipt of high cumulative benefits, however. About half of recently disabled workers receiving benefits from SSDI and other programs receive SSI or other welfare benefits, according to survey data. Since SSI and other welfare benefits are means-tested, total benefits received by these disabled persons are low compared to average disability benefits.

Receipt of high cumulative benefits is limited to a degree because some benefits are reduced, in part or totally, when benefits are received from other programs. For example, means-tested benefits or welfare payments are reduced dollar-for-dollar by other benefit payments; SSDI and Black Lung programs offset benefits received from state workers' compensation programs; and civil-service disability and federal workers' compensation benefits cannot be received concurrently for the same disability.

Receipt of nonintegrated benefits from public programs has been a legislative issue in recent years. The Omnibus Budget Reconciliation Act of 1981 (Public Law 97-35) requires new SSDI benefit awards to be reduced by amounts received from some other public programs. The provision limits combined program benefits to 80 percent of average current (predisability) earnings--the same offset provision that is used against workers' compensation benefits. It applies to new awards under several public programs, but excludes means-tested benefits, veterans' program benefits, and public pension benefits based on public employment that was also covered by Social Security.

The exclusion of veterans' compensation benefits and the prospective nature of the SSDI cap will limit the effectiveness of this legislation, since a major part of the overlap problem involves these two programs and all current beneficiaries will make up a high proportion of the recipient population for years to come. Veterans' compensation beneficiaries currently make up about 25 percent of SSDI recipients who receive other benefits; about half of this group replace more than 80 percent of their previous earnings.[19] Moreover, this group will probably continue to make up the larger proportion of SSDI beneficiaries with duplicative payments over the next decade. Those entitled to SSDI benefits before 1980 also were awarded payments resulting in higher earnings replacements than those entitled later.

Causes of Low Replacement Rates

Disability beneficiaries are more likely to receive low than high earnings replacements. For example, survey data indicate that about 40 percent of all recently disabled beneficiaries receive cash benefits replacing less than 35 percent of previous earnings, whereas less than 30 percent receive high replacements.

Like high replacement, low replacement of earnings occurs because of the way benefits are calculated. Means-tested benefits from programs such as SSI, for example, are not based on previous earnings but provide a minimum amount of income relative to the national poverty standards. Consequently, workers who are only eligible for SSI benefits may have low replacement rates. Also, benefits that are based on a schedule or on severity of impairment, as in veterans' compensation, often replace less than half of predisability earnings, especially when there is only a partial disability. Finally, SSDI and private pension beneficiaries receive low earnings replacement in cases where recent earnings previous to disability were significantly higher than average career earnings. Due mainly to the "tilt" in the Social Security benefit structure that favors low-income workers, some SSDI beneficiaries with high previous earnings can also receive above-average dollar amounts, but low benefits relative to their previous earnings.

In past years, replacement rates among severely disabled state workers' compensation beneficiaries have been noticeably low, since state maximum payments were lower than national average weekly wages.[20] Lump sum payments from some state programs can

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19. U.S. General Accounting Office, Limits on Receipt of Multiple Disability Benefits Could Save Millions, p. 6.

20. In 1975, average replacements of 12 percent were observed among permanently impaired workers receiving benefits from state workers' compensation programs in California, Florida, New York, Washington, and Wisconsin. See William G. Johnson, (continued)

also result in particularly low replacement rates if no benefits are received from other sources.

Problems in Measuring and Comparing Earnings Replacement Rates

Different methods of computing previous earnings provide different estimates of replacement rates, particularly in the proportion of beneficiaries with very high or very low replacement rates. For example, a comparison of SSDI replacement rates based either on earnings in the year before disability or on lifetime covered earnings shows substantial variation in the number of persons with replacement rates below 40 percent or above 200 percent.[21] Replacement rates based on earnings in the last year before disability were often higher than replacement rates based on lifetime earnings; such differences are often observed when earnings fall gradually during the period before individuals become totally disabled. Median replacement rates for the same years, however, differed by less than 1 percent.

Consequently, caution is necessary when interpreting replacement rates based on the last year's earnings. First, as noted above, lower than normal earnings in the year before disability can cause an overstatement of the replacement level. This is particularly likely when programs actually relate disability compensation to average earnings over the highest three years of covered employment rather than the most recent years. To diminish overstatements, predisability earnings might also be adjusted for potential earnings in an established career.[22] Second, high

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20. (continued)
Paul Cullinan, and William P. Currington, "The Adequacy of Workers' Compensation Benefits," Research Report of the Interdepartmental Workers' Compensation Task Force, vol. 6 (June 1979), p. 95.

21. L. Scott Muller and Mordechai E. Lando, "Replacement of Earnings of the Disabled under Social Security: Levels and Trends 1969-75," Research Report No. 53, Social Security Administration (June 1980), p. 10.

22. For an extensive discussion on adjusting measures of predisability earnings for potential earnings, see William G. Johnson and others, "The Adequacy of Workers' Compensation Benefits," p. 102.

medical expenses for severely disabled beneficiaries can also mean that replacement rates appear artificially high. For example, when survey-reported medical expenses paid by the beneficiaries are subtracted from benefit payments to severely disabled persons in 1978, median replacement rates drop about four percentage points. On the other hand, replacement rates may understate the value of benefits received. For disability recipients who can continue some work, one might want to compare the sum of earnings after disability plus benefits to predisability earnings.

WORK DISINCENTIVES

This section of the paper discusses another important issue in the disability system: the existence of work disincentives. Program administrators and many in the Congress are concerned that program costs are unnecessarily high because current cash benefits discourage disabled workers and disabled beneficiaries who could work from returning to jobs after medical recovery. Significant increases in disability program caseloads in past years may be evidence of a growing problem of work disincentives.[23] On the other hand, many disabled persons who can work are doing so, and lack of available jobs or flexible working conditions may prevent others from working. Also, work disincentives may be an inherent problem in disability programs since often the inability to work is a requirement for the receipt of benefits and a major determinant of "ability to work" is whether the potential recipient has earnings above specified levels.

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23. During the past decade, decreases in the number of beneficiary terminations for recovery occurred at the same time as increases in awards from major disability programs like SSDI and CS. For example, while SSDI beneficiaries doubled between 1969 and 1976, the number of disabled workers leaving the rolls due to recovery declined from 28 per 1,000 disabled workers to 15 per 1,000. Recovery rates rose to 22 per 1,000 in 1977, however, the first increase in the entire period, and 25 per 1,000 in 1979. See Social Security Administration, Experience of Disabled Worker Benefits Under OASDI, 1974-78, Actuarial Study No. 81 (April 1980).

Causes of Work Disincentives

Several characteristics of current disability programs create work disincentives. In particular, program provisions that reduce or cut off cash and medical benefits when earnings increase or that permit high income replacement rates--due either to high benefit levels or to high cumulative benefits from more than one program--make working less compelling. Additional factors that interact with work disincentives, such as age and other family income, may also independently influence decisions to work.

Work or Earnings Tests. Tests of earnings capability have a twofold purpose--to indicate probable recovery and to show when disability benefits could cease without causing hardships. While work or earnings tests are designed to reduce program expenditures by eliminating benefits to recovered persons, a poorly designed work test can cost money if many beneficiaries are discouraged from working.

Work tests can discourage disabled beneficiaries from working at all, because they fear loss or reduction in cash and medical benefits, while the "notch" level, or level of earnings allowed before benefits are eliminated, can encourage beneficiaries to limit their work effort to the allowable amount. For example, the substantial gainful activity (SGA) level in SSDI is the amount of earnings above which a disabled beneficiary is considered to be recovered--about $300 per month. After an extended period of time, earnings above this amount will result in termination of benefits and subsequent loss of medical benefits. Hence, a recovering worker may keep earnings below this amount to prevent drastic changes in income, particularly from large out-of-pocket medical expenses.

There are two main reasons why disabled persons may respond in this way to work tests. First, when a program has a work test, beneficiaries' decisions to work involve measuring the loss of disability benefits against the probable or expected gain from earnings. To break even financially, the expected increase in earned income after taxes must be greater than the benefit loss. Second, earnings from available jobs may be lower than past wages, since disabled persons are often unable to return to their pre-disability occupations, and their earnings may not grow as quickly over time as before they were disabled. For these reasons, beneficiaries could find it advantageous to earn less than the work-test amount and remain on the disability rolls where many benefits automatically increase each year with inflation.

High Income Replacement Rates. High income replacement rates and increasing benefit levels in disability compensation programs also reduce the incentives to work. When benefits replace a high proportion of predisability earnings, the gains from working would seem comparatively smaller than if benefits are low. Recent studies of SSDI recipients show that over the last decade measurable decreases in recovery rates coincided with increases in Social Security benefit payments, particularly benefit increases that exceeded increases in wage levels.[24] One study found that among disabled workers with conditions most subject to medical recovery, those with high replacement rates were less likely to leave the disability insurance rolls than those with low replacement rates.[25]

Analyses of labor force participation before and after large increases in benefit levels and expanded program coverage indicate that high benefits may encourage persons to stop working. For example, one study of labor force participation among middle-aged men between 1957 and 1975 positively associated the increase in expected benefits with increases in SSDI participation rates and decreased labor force participation.[26] Other studies have confirmed a significant relationship between the generosity of disability transfers and decreasing labor force participation among older male workers, albeit to varying degrees.[27]

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24. Robert J. Myers, "Actuarial Analysis of Operation of Disability Insurance System Under Social Security Program," appearing in the House Ways and Means Committee, Actuarial Condition of Disability Insurance, 1978, 96:1 (February 1979).

25. Ralph Treitel, "Recovery of Disabled Beneficiaries: A 1975 Followup Study of 1972 Allowances," Social Security Bulletin (April 1979).

26. Jonathan Leonard, The Social Security Disability Program and Labor Force Participation, pp. 12-18. See a further discussion of this study in Appendix C.

27. See Robert H. Haveman and Barbara L. Wolfe, "Have Disability Transfers Caused the Decline in Older Male Labor Force Participation? A Work-Status Rational Choice Model," Institute for Research on Poverty, University of Wisconsin-Madison (October 1981); and Donald Parsons, "The Decline in Male Labor Force Participation," Journal of Political Economy (February 1980).

Additional Factors. Factors influencing the work decisions of a disabled person include the severity of the health problem; the person's sex, age, and education level; family responsibilities; and being able to return to the same employer or having flexible working hours. Many empirical analyses have attempted to describe these factors for different population groups; the results show which demographic or social factors have an effect on work choices, but usually do not measure their importance against each other or against economic incentives. A summary of the important results of some of these analyses is given in Appendix C.

It is not certain to what extent labor market conditions influence work decisions of disabled persons, although discrimination in the workplace has been apparent. Disabled persons are often the first to be laid off and the last rehired in times of economic recession.[28] Moreover, persons with declining health status may opt for disability benefits rather than earned income when the maintenance of a regular job becomes more uncertain or requires more competition with persons in good health.

Recent Efforts to Increase Work Incentives

Over the past six years, many efforts have been made to increase work incentives for disabled beneficiaries. These have included modifications to program provisions thought to cause work disincentives, and the expansion of rehabilitation programs. The former measures will probably help to determine the extent of work disincentives, whereas the latter measures were designed to improve work capabilities and job opportunities.

Modifying Program Provisions. Several measures were enacted by the Disability Amendments of 1980 to counteract the work disincentives of the earnings limitations in the SSDI and SSI programs. These measures included: (1) liberalizing work-expense deductions so that disabled workers' earnings capabilities would

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28. For an extensive discussion of this and of recent attempts to combat discrimination against disabled workers, see Sar A. Levitan and Robert Taggart, Jobs for the Disabled (Johns Hopkins University Press, 1977) and Monroe Berkowitz, "Social Policy and the Disabled: The Main Issues," Social Security and Disability Issues in Policy Research (International Social Security Association, 1981).

not be overstated when they are employed in gainful activities; (2) establishing extended trial work periods within which beneficiaries could be automatically reentitled to benefits after earnings decreased or ability to work ended; (3) extending Medicare coverage to allow recovering SSDI beneficiaries up to four years of coverage after returning to work; and (4) initiating demonstration projects to test different methods for encouraging disabled persons to return to work--for example, providing a tax rate against full SSDI benefits when earnings exceed the SGA level, rather than ending benefits.

Rehabilitation Services. Much attention has been paid recently to the effectiveness of state-federal rehabilitation programs designed to aid SSDI or SSI beneficiaries, but the success of increased rehabilitation efforts in the past has been difficult to ascertain. Some observers have contended that more money has been spent for smaller gains in recovered disability cases than in previous years. For example, between 1970 and 1979 the annual number of participants in the rehabilitation program funded by the Social Security Administration increased almost 170 percent, but the number of rehabilitated persons increased only 43 percent. On the other hand, the number recovering and leaving the rehabilitation rolls has increased each year since 1970, both in absolute numbers and in proportion to the number served.[29]

For those recipients who complete rehabilitation and leave the disability rolls, program savings outweigh the program costs. Recent studies have shown that rehabilitated individuals who terminate SSDI beneficiary status and return to the work force produce savings to the program within ten years after case closure.[30] The same studies also indicate, however, that later costs for those rehabilitated persons returning to the SSDI rolls greatly outweigh the earlier savings that resulted from reduced

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29. See Leo A. McManus, "Evaluation of Disability Insurance Savings Due to Beneficiary Rehabilitation," Social Security Bulletin (February 1981), pp. 19-26.

30. Ibid. The study found savings to the SSDI trust fund ranged from $1.39 to $2.72 for each dollar spent on rehabilitation clients. Another study by GAO produced a smaller savings/cost ratio--$1.15 per dollar spent. See Comptroller General of the United States, "Improvements Needed in Rehabilitating Social Security Disability Insurance Beneficiaries," Report to Congress (May 1976).

benefits and increased tax revenue obtained during their productive work periods.

The most recent change in state-federal rehabilitation services is to reduce federal funding for SSDI and SSI beneficiaries. Until the enactment of Public Law 97-35, the Social Security trust funds financed the costs of rehabilitating disabled beneficiaries (paying about $87 million in fiscal year 1981) as long as they were in a state-operated program subject to Title I of the Rehabilitation Act of 1973. Since September 1981, the trust funds only pay for vocational rehabilitation services in special cases--where the disabled beneficiary completes a continuous nine-month work period, for example.[31] This measure will probably cause more targeting of resources on those most likely to become rehabilitated, but the effect may be the elimination of services to many SSDI beneficiaries, since state funds may be limited.

31. The Disability Amendments of 1982 (H.R. 6181), a bill reported out of the Ways and Means Committee, would provide advance payments from the trust funds to state agencies or private organizations for vocational rehabilitation of disabled beneficiaries and persons terminated from the disability rolls due to recovery, in order to make vocational evaluation and job placement services more readily available.

CHAPTER IV. OPTIONS

This chapter presents options for changing the federal disability programs, designed to meet the problems surveyed in the preceding chapter. It also discusses the probable impacts such changes would have on programs operated by state and local governments and by private organizations.

The options are of two kinds: (1) those that would alter and retarget program coverage, and (2) those that would reduce the benefit levels of some programs. The general approaches are explained before the specific options are described in detail. Other options such as raising welfare benefit levels and changing vocational rehabilitation practices are also discussed, because they address additional concerns about disability compensation and can augment the primary options discussed below.

OPTIONS TO ALTER DISABILITY COVERAGE

Program coverage could be altered by modifying eligibility criteria or by shifting eligibility for benefits from one program to another. The objectives would be to fill gaps in disability coverage, coordinate benefit levels so as to minimize duplication of benefits, or retarget cash benefits on those most disabled or most in need. Broader disability coverage would bring in persons normally lacking coverage under current programs--for example, government employees nonvested in the civil service retirement system. Retargeting benefits would involve either changing the number of persons eligible for specific benefits, often reducing total benefits for many, or eliminating benefits for whole groups--such as those with minor impairments. The goal of altering or targeting benefits in this manner would be to make sure that limited resources go to those most in need.

Options that alter or retarget disability coverage are designed to improve the adequacy or the effectiveness of disability compensation programs. Alternative ways of accomplishing these goals include:

- Adopting SSDI coverage for all workers;

- o Consolidating certain federal disability programs, particularly SSI and veterans' pensions; and

- o Retargeting veterans' benefits on the most disabled veterans by eliminating payments to those with low-rated disabilities.

Adopting Universal Disability Coverage Under Social Security

This option would extend disability coverage to all workers and thereby expand the number of totally disabled workers eligible for disability income. Under this plan, Social Security disability taxes would be paid by an additional 10 percent of those employed--roughly 10 million persons--who would then be entitled to disability benefits when they met program requirements. This plan would also eliminate problems of transferring disability coverage when a worker shifts between covered and noncovered jobs--primarily between government and private-sector employment.

This option could use numerous ways to integrate benefits when a person is covered by more than one program. For example, it could make use of program offsets similar to those of private pensions. Such provisions allow a combined benefit of 60 to 80 percent of predisability earnings. Current SSDI program provisions that limit combined benefits from public sources might be sufficient for this purpose. For example, combined benefits awarded from both SSDI and civil service disability retirement are limited to 80 percent of average current (predisability) earnings.

Extending Social Security coverage would affect mainly employees not currently covered by Social Security in federal, state, and local government, and in some nonprofit organizations. Almost all federal workers and about 25 percent of state and local government employees are not now covered by Social Security (see Chapter III); in 1983, these employees and their employers would together contribute 1.65 percent of taxable earnings to the Disability Insurance Trust Fund. Currently, about 55 percent of federal employees nonvested in the civil service retirement system are under age 30; although many of these workers already have some Social Security coverage, about 200,000 federal workers could become newly insured for disability within five years under this option.

The costs of implementing this proposal would be completely offset by increased Social Security tax revenues from workers who are not now covered. Although few data exist on disability incidence rates among the noncovered population, historical disability incidence rates among workers newly insured after two years under SSDI would indicate that initial costs for this program would be less than $50 million in 1985, if implemented in 1983. Benefit costs in the later years would be considerably higher, since more persons would be eligible for benefits. Increased tax revenues in 1985 could be $1.9 billion, however. Net revenue increases would total $9.0 billion in 1983 through 1987.[1]

A problem with the option is that many workers required to pay the tax would get little coverage beyond what they have now under other programs, such as civil service retirement. Also it would not significantly affect the large number of persons currently covered by SSDI who, because of health problems, often must form loose attachments to the labor force and subsequently lose insured status. Some have suggested that an easing of vesting or insurability rules or relaxation of the criteria for eligibility for SSI benefits would better meet the goals of universal coverage. Such alternatives could lead to serious work incentive problems, however, since some temporarily disabled persons would have economic incentives to continue receiving disability benefits rather than returning to work.

Consolidating Federal Programs

Federal programs that have similar objectives and benefit schemes, but are administered as separate programs, often serving the same group of persons, could be consolidated to improve their efficiency and effectiveness. For example, the military and civil service disability retirement programs have considerable overlap--that is, similar requirements and benefit formulas; veterans' compensation and military disability retirement programs serve persons with the same background--those with active military service; and SSDI and civil service disability and railroad retirement programs have similar objectives. One example of

1. Estimates of increased revenue represent budget receipts and do not include payments from the federal government as the employer. Revenue estimates were derived by Ken Sander of the Office of Research and Statistics, Social Security Administration.

consolidating federal programs is given below: that of replacing veterans' pensions with SSI.

Phase Out Veterans' Pension Benefits. Federal disability expenditures could be retargeted and reduced by phasing out and eventually eliminating veterans' disability pensions, which essentially overlap SSI coverage. Veterans' pension benefits are available to needy veterans of wartime service whose disabilities are not service-connected and who are either totally and permanently disabled or age 65 or older. Almost 50 percent of veterans receiving pensions now qualify on the basis of age. Surviving spouses and children of war veterans are also eligible for means-tested pensions--about two-thirds of the benefit levels for veterans--but they are not required to be disabled or aged. SSI is provided to needy disabled and aged persons, but SSI benefits are not available to their dependents or survivors unless they are also aged or disabled. Benefit levels under SSI are, in most cases, lower than those available from veterans' pensions.

This option would consolidate the two programs under SSI provisions. Veterans and all survivors who are currently on the rolls would maintain their current pension benefits, but new applicants would apply for SSI instead of veterans' pensions.

Consolidating veterans' pensions with SSI would save both administrative and cash benefit costs. Gross savings would amount to about $220 million in 1983, but would be offset by about $120 million in expenditures from SSI and other welfare programs, leaving a net savings of $100 million. Net savings in 1983-1987 could reach $6.5 billion, however.

The primary advantage of implementing this proposal is that it would consolidate two programs with similar goals serving similar populations, but target their benefits on the most needy. Proponents suggest that the benefit guarantee level in the SSI program adequately assists true welfare cases and that the same benefits should be provided to all needy persons, regardless of past military service. It is argued that if a higher standard of need is considered for poor veterans, then perhaps it should be extended to all poor disabled persons. For example, SSI benefits could be raised to poverty levels to improve benefits for all those under the consolidated program. (See a discussion of this option later in this chapter.)

Opponents of this proposal argue that the veterans' pension is a payment owed to wartime veterans for services rendered, and that veterans should be provided income assistance greater than the level available under SSI. Although veterans may receive pensions for non-service-connected disabilities, opponents suggest that such veterans were reduced to the level of need because they were unable to pursue more lucrative careers while in service.

Retargeting Veterans' Benefits on the Most Disabled[2]

This option would eliminate periodic benefits now paid to some partially disabled persons under a different program for veterans--the Veterans' Service-Connected Disability Compensation program. It would continue benefits only to those who were determined to be at least 30 percent disabled and therefore presumed to have lost at least 30 percent of their earning capacity. Those veterans with lesser disabilities--that is, with minor medical problems such as flat feet or an amputated finger--would remain registered with the Veterans Administration as service-disabled, continue receiving medical or hospital benefits, and receive cash benefits later if their disabilities worsen.

This option would eliminate nearly 1.3 million persons, or 56 percent of veteran beneficiaries, from veterans' compensation rolls in 1983.[3] Savings from applying this option would be $1.2 billion in 1983 and about $7.4 billion through 1987.

It is doubtful that low-rated disabilities actually cause large reductions in earning capacities, and therefore justify long-term periodic benefits. Whether earning capacity is lost

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2. Under current law, additional dependents' allowances are paid to veterans with disabilities rated as low as 30 percent. The President's 1983 budget proposed eliminating dependents' benefits for those veterans with disability ratings below 50 percent. That measure would produce smaller savings--$146 million in 1983--than the option discussed here and it would not affect benefits to 10- or 20-percent disabled veterans.

3. At the end of September 1981, about 44 percent of veteran beneficiaries on the rolls of Veterans' Service-Connected Disability Compensation were classified as having combined disability ratings of 30 percent or higher. About 6 percent or 135,000 veterans were rated 100 percent disabled.

may be less important, however, than providing some compensation for illness or injury incurred while in service. Veterans' compensation payments are considered by some to be indemnity payments.

OPTIONS TO REDUCE BENEFIT LEVELS

One way to control expenditures for disability programs would be to reduce benefit levels. Proponents see this as a means of reducing expenditures, improving work incentives, and, in many cases, providing similar treatment for disabled persons in different programs. Lower benefit levels would conserve scarce resources--which is especially important in a time of federal budget stringency--and would encourage temporarily disabled persons to seek employment (see Chapter III).

Disability expenditures could be reduced by adopting an across-the-board cut in program benefits. A reduction in cost-of-living adjustments (COLAs) would exemplify this type of strategy.[4] This approach would reduce expenditures by affecting all beneficiaries in a similar way, whereas additional caps on total benefits would affect some program beneficiaries--those with the highest benefits now--more than others.

Options to reduce disability benefits often redefine or place a ceiling on the portion of predisability income that benefits will replace. The Disability Amendments of 1980, for example, established a special cap on family benefit levels for new SSDI awards. The intent of the new law was to prevent benefits from exceeding the family's previous after-tax income--in this case, about 85 percent of pre-tax, average earnings.

Alternative methods for reducing disability benefits include:

- Reducing the COLAs for federal program benefits;
- Limiting federal workers' compensation benefits to 80 percent of predisability take-home pay;

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4. Adjustment of the COLA for disability benefits would likely be part of a larger policy change that would also affect other federal programs (Old Age and Survivors' retirement benefits, for example).

- o Extending the SSDI megacap on combined payments to include veterans' compensation beneficiaries; and

- o Taxing a portion of disability benefits.

Reducing the COLAs for Federal Benefits

One way to reduce federal disability expenditures would be to lower the cost-of-living adjustments (COLAs) for federal benefit payments. Currently, all federal disability benefits are adjusted annually and, except for veterans' compensation and Black Lung Benefits, are automatically indexed by the full increase in the Consumer Price Index (CPI).[4] The CPI adjustments have caused payments to rise faster than wages over the last three years. Because of this, receipt of benefits may be preferred to earned income by some disabled persons who are able to work.

Several different methods of reducing COLAs have been suggested in recent years, all aimed at reducing total program expenditures. Some proposals would reduce COLAs by a fixed percentage--for example, 15 or 33 percent of the increase in the CPI. Other proposals would require COLAs equivalent to the lesser of price or wage increases, although this would not reduce expenditures under current economic projections.[5] One reason to modify the 100-percent change in the CPI for indexing benefits is that the CPI may overstate the increases in the costs of certain items for retired or disabled persons, such as the cost of housing. The Administration has proposed limited COLAs for the federal military and civilian retirement and disability programs in its 1983 budget.

Reducing the COLAs based on the CPI to two-thirds of the increase in the CPI, beginning after July 1982, would save the

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4. Legislated increases in veterans' compensation payments are usually equivalent to increases in Social Security payments, whereas Black Lung benefit increases are tied to federal pay raises. For the specific change in the CPI used to index benefits in particular programs, see Appendix A.

5. See, for example, Congressional Budget Office, Reducing the Federal Deficit: Strategies and Options (February 1982) and Indexing with the Consumer Price Index: Problems and Alternatives (June 1981).

federal government about $540 million in 1983 disability expenditures, for example. Cumulative savings over the next five years would be about $17 billion.

One advantage in cutting the COLAs by one-third for each of the next five years is that it would help to control disability expenditures, while still allowing a substantial adjustment for inflation. In addition, proponents suggest that the two-thirds increase would be adequate additional compensation since disabled workers generally receive tax-free benefits and therefore do not see their incomes erode from inflation as quickly as others who pay taxes on their earnings. On the other hand, it is argued that many benefits are low compared to predisability incomes, so that full CPI indexing helps to combat inadequate disability incomes. For example, some suggest that COLAs for means-tested benefits should not be changed.

Limiting FECA Benefits to 80 Percent of Predisability Take-Home Pay

Another way to reduce program benefit levels would be to limit payments from the federal workers' compensation (FECA) program to 80 percent of the beneficiary's previous take-home pay--that is, to 80 percent of gross pay (earnings) minus federal, state, and local income taxes, as well as Social Security taxes and pension contributions paid in the year before the disability occurred, but adjusted for inflation in later years. In general, this would limit initial payments to about 60 percent of gross predisability earnings. This option was originally offered as a modification to FECA benefits in the Omnibus Reconciliation Act of 1981 and was proposed in the President's original 1983 budget request.[6]

The proposal would affect all FECA beneficiaries, although it would have greater impact upon higher-income federal workers. According to the Department of Labor, higher-income employees--for example, those in grade GS-11 and above positions--including those workers with dependents, typically receive more than 100 percent of take-home pay in benefits. In general, the proposal would cause a 10 to 30 percent reduction in maximum replacement rates for about 49,000 claimants. Net savings would be about $50 million in fiscal year 1983 and $230 million in 1983-1987.

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6. See Congressional Record, daily ed., June 26, 1981, pp. 3773-8. Also, see H.R. 4388--a bill before the 97th Congress.